

## Changes to California Real Estate Withholding Law for 2005

### – AB 1338 –

Assembly Bill 1338 amends Revenue and Taxation Code Sections 18662 and 18668 making changes to real estate withholding requirements and exemptions effective for all transactions closing on or after January 1, 2005. The main changes are:

- Replaces the waiver process for non-individuals with a self-certification process. Although non-individuals will not be able to request reduced withholding on small gains, they will be able to self-certify that they are exempt from withholding if they will have a loss on the sale, are doing an IRC Section 1031 exchange, or the property is being involuntarily converted and the seller intends to replace it to meet the requirements of IRC Section 1033.
- Expands the exception for the sale of a principal residence to include sellers whose “last use” of the property sold was their principal residence even though they do not meet the “two out of the last five years” requirement or one of the special circumstances.
- Clarifies that no withholding is required when the transferee acquires the property: at a sale pursuant to a power of sale under a mortgage or deed of trust, at a sale pursuant to a decree of foreclosure, or by a deed in lieu of foreclosure.
- Expands the exemption for the sale of a principal residence to include sales by estates when the property was the decedent’s principal residence.
- Does not provide for an exemption for irrevocable trusts that have a California resident trustee.
- Does not provide for an exemption for estates when the decedent was a California resident.

The following chart is a comparison of the real estate withholding requirements prior to AB 1338 and an explanation of how AB 1338 changed the requirements:

	Escrows Closing between January 1, 2003 and December 31, 2004	Escrows Closing on or <u>after</u> January 1, 2005
<b>Sellers Subject to Withholding</b>	All individuals (residents and nonresidents) and non-individuals with a last known street address outside California.	No change for individuals. However, for non-individuals, a California street address is no longer a general reason for not withholding. Sales by non-individuals must be withheld upon unless the non-individual seller meets one of the certifiable exemptions.
<b>Rate</b>	The withholding rate is 3½ percent of the total sales price.	No change.
<b>Threshold</b>	Withholding is only required if the total sales price exceeds \$100,000.	No change.
<b>Small Gain – Individuals</b>	Full withholding is required unless the individual has a loss on the sale for California income tax purposes.	No change.
<b>Small Gain – Non-individuals</b>	Non-individuals can request a waiver or reduced amount of withholding if the gain on the sale will result in significantly less California income tax than the statutory withholding amount.	Non-individual sellers can no longer request a waiver or a reduced withholding rate based upon a small gain. (However, see Certifiable Exemptions for Non-individual sellers below.)
<b>Multiple Sellers – Individuals</b>	Withhold according to the seller’s interest in the property. (Individuals cannot request a reduced withholding amount.)	No Change.
<b>Multiple Sellers – Non-individuals</b>	If there are multiple sellers only some of which are non-California, non-individuals, you must withhold on the total sales price even though the non-California, non-individual only owns a portion of the property. Non-California, non-individuals can request a reduced withholding amount.	Withhold according to the seller’s interest in the property.

	Escrows Closing between January 1, 2003 and December 31, 2004	Escrows Closing on or <u>after</u> January 1, 2005
<b>Certifiable Exemptions – Individuals</b>	<p>No withholding is required if an <u>individual</u> seller is:</p> <ul style="list-style-type: none"> <li>• Selling a property that qualifies as the seller's principal residence within the meaning of Internal Revenue Code (IRC) Section 121 (seller must have owned and lived in property as principal residence for 2 out of last 5 years).</li> <li>• Selling the property at a loss for California income tax purposes.</li> <li>• Selling the property as part of an IRC Section 1031 exchange.</li> <li>• Selling the property because of an involuntary conversion and will replace the property within the provisions of IRC Section 1033.</li> </ul>	<p>In addition to the existing certifiable exemptions, the principal residence exemption is expanded for <u>individual</u> sellers when:</p> <ul style="list-style-type: none"> <li>• The last use of the property sold was their principal residence, even if they did not meet the two out of the last five years requirement or one of the special circumstances.</li> </ul>
<b>Certifiable Exemptions – Non-individuals</b>	<p>No withholding is required if a <u>non-individual</u> seller is:</p> <ul style="list-style-type: none"> <li>• A corporation with a permanent place of business in California,</li> <li>• A partnership or LLC classified as a partnership,</li> <li>• A tax exempt entity, insurance company, IRA, or qualified pension plan,</li> <li>• An irrevocable trust with CA trustee,</li> <li>• An estate with CA decedent.</li> </ul>	<p><b>Added</b> certifiable exemptions for:</p> <ul style="list-style-type: none"> <li>• Sale of the property at a loss for California income tax purposes.</li> <li>• Sale of the property as part of an IRC Section 1031 exchange.</li> <li>• Sale by estates when the property was the decedent's principal residence.</li> </ul> <p><b>Eliminated</b> certifiable exemptions for:</p> <ul style="list-style-type: none"> <li>• An irrevocable trust with CA trustee.</li> <li>• An estate with California resident decedent.</li> </ul>
<b>Exchanges – Individuals</b>	Individuals can certify that the transfer is part of an IRC Section 1031 exchange.	No change.
<b>Exchanges – Non-individuals</b>	Non-individuals can request a <b>waiver</b> if the transfer is part of an IRC Section 1031 exchange.	Non-individuals can <b>certify</b> that the transfer is part of an IRC Section 1031 exchange.
<b>Waivers &amp; Reduced Withholding – Individuals</b>	There is no waiver process for individuals. The full amount of withholding is required unless the sellers can certify that they meet one of the exceptions or the buyer agrees to withhold on each payment of an installment sale.	No change.
<b>Waivers &amp; Reduced Withholding – Non-individuals</b>	Non-individuals can request a waiver or reduced amount of withholding when there is little or no gain on the sale or the estimated California income tax is significantly less than the statutory withholding amount.	There is no waiver process for non-individuals. The full amount of withholding is required unless the seller certifies that they meet one of the exceptions or the buyer agrees to withhold on <u>each</u> payment of an installment sale.